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Dear Lesley

Statutory Consultation – Supplier Licensing Review: Ongoing requirements and exit arrangements

We welcome the opportunity to comment on Ofgem's proposals to improve regulatory standards for existing suppliers. This response represents the views of SSE Business Energy (SSE Energy Supply Limited).

SSE Business Energy considers that the Supplier Licensing Review has significant potential to minimise the avoidable costs of supplier failure by preventing consumers and suppliers from absorbing shortfalls in costs, such as those required under the Renewables Obligation (RO) scheme. Ultimately, poor practices and business models which lead to supplier failure are inexcusable and we therefore support Ofgem's aim to reduce the resulting risk and impact on other market participants.

Within this response we have highlighted some key points:

1. With Ofgem reporting that almost 1-in-5 suppliers failed to fully discharge their obligations under the 2018-19 RO, triggering a £97.5m mutualisation cost, we consider that Ofgem's Financial Responsibility Principle on its own will not prevent the current financial consequences of supplier failure.
2. At £6.4 billion annually, the RO is the largest low carbon scheme. The most effective approach to minimise cost mutualisation is to implement prescriptive credit protections which would align the RO to the same standards as other low carbon schemes. This would be simpler for Ofgem to monitor and enforce by comparison to the Financial Responsibility Principle.
3. Following two years of mutualisation being triggered we welcome the introduction of this Principle, but we consider that it is imperative Ofgem move promptly to consult on the next phase of the Supplier Licensing Review to minimise the risk of further waves of mutualisation.

Any delay in moving to more robust protection (phase-two) for RO cost mutualisation presents a considerable risk of harm to consumers in the near-term. SSE Business Energy urges Ofgem to progress as soon as possible to implement prescriptive measures to ensure consumers do not continue to pay twice for renewable energy.

We have set out a more detailed response to Ofgem's proposals in Annex 1 and we look forward to discussing our views further with Ofgem in due course.

Yours sincerely,

Christie Thomson
Senior Regulation Analyst – Customer Solutions GB

Annex 1

Cost mutualisation causes consumers to pay twice

RO mutualisation continues to represent the biggest single cost of supplier failure – representing almost 40% of the £255m total cost to the industry of supplier failures.[1] Despite a legal requirement to comply with the RO scheme, Ofgem acknowledged that in 2019, 21 suppliers (~17%) failed to discharge their obligation in full resulting in a mutualisation cost, ultimately borne by consumers, of £97.5m.[2] The only way to prevent this consumer detriment is to proceed imminently to a more prescriptive approach, including robust credit requirements and more rigorous enforcement in the event of non-compliance.

Consumers already pay towards the RO via routine billing arrangements but are then subject to additional costs from the scheme when mutualisation is triggered. This may take the form of tariff adjustments, customer pass-through arrangements, or suppliers pricing in the expected additional cost of mutualisation into their fixed tariffs. We do not consider that this represents a fair outcome for consumers and would urge Ofgem take stronger action to protect them. We understand that Ofgem's proposed Strategic Narrative includes the objective of progressing decarbonisation of the energy sector and enabling the most effective transition to net zero at the lowest cost to consumers.[3] This is at risk due to current mutualisation arrangements – a low cost to consumers cannot be achieved whilst they continue to pay twofold for renewable energy.

We continue to believe that Ofgem should consider credit options, or, as a viable alternative to posting credit, suppliers should be given the opportunity to redeem held ROCs against their obligation earlier in the scheme year period as part of, or in lieu of, an alternative payment guarantee method.

A prescriptive approach will benefit Ofgem, suppliers and consumers alike

The Financial Responsibility Principle

Whilst we understand Ofgem's rationale for implementing a Financial Responsibility Principle based on feedback from supplier workshops in November 2019, we do not consider this to be an effective control in isolation. Therefore, the immediate need to protect consumers from the financial impacts associated with failed suppliers has still not been satisfactorily addressed. It was expected that Ofgem would impose the principle as a stop-gap measure before swiftly progressing to second-phase prescriptive measures, so we would urge Ofgem to set out its plans as to how this will be achieved alongside the publication of this Statutory Consultation.

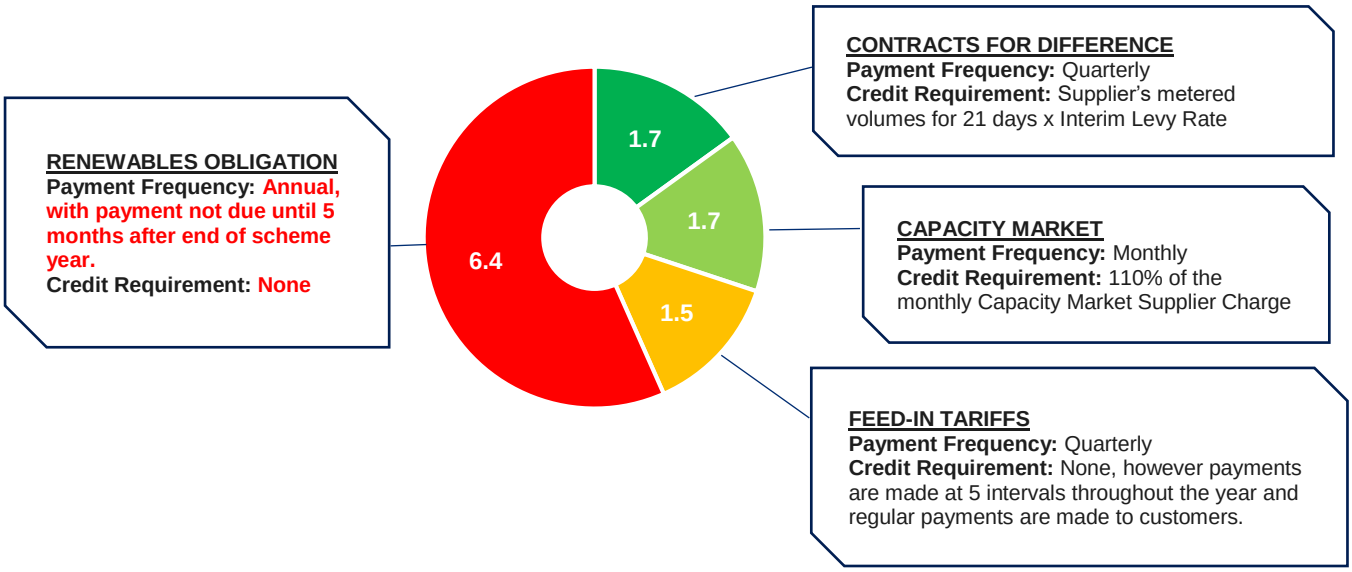
Fundamentally, a principle-based approach will not serve as a guaranteed mechanism to reduce costs arising from mutualisation and therefore will not achieve the desired outcome of minimising the avoidable

[1] Citizens Advice, Picking up the pieces, December 2019 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/Picking%20up%20pieces%20updated.pdf
[2] https://www.ofgem.gov.uk/publications-and-updates/renewables-obligation-late-payment-distribution-2018-2019
[3] https://www.ofgem.gov.uk/system/files/docs/2019/12/fwp_programme_2020_22_web.pdf

risk of supplier failure and protecting consumers from increased costs. In order to be effective, Ofgem would be required to take a much more rigorous approach to compliance monitoring.

By contrast, material payables for other industry schemes typically require suppliers to protect a proportion of costs by posting credit, therefore it is reasonable that suppliers should be expected to follow similar requirements for RO costs. Additionally, payments are required at more frequent intervals for other industry schemes, which tends to reduce the likelihood of these charges tipping the balance towards supplier failure when compared with a larger annual payment and also reduces the magnitude of non-compliance costs if mutualisation were triggered. We have highlighted the disparity between the costs, credit requirements and payment intervals of other government/industry schemes and the current RO arrangements below.

Scheme Costs - £Billion



SSE Business Energy's view is that the Financial Responsibility Principle, whilst welcome, will not on its own go far enough to prevent suppliers from failing to prepare to meet required costs. This is also echoed by Citizens Advice who highlighted in its Picking Up the Pieces report that by the time Ofgem becomes aware of the problem each year, it may already be too late.[4]

The efficacy of the principle will also be difficult to measure and would require a further wave of supplier exits / failures before any conclusion on its effectiveness could be reached. This is particularly pertinent as we approach RO payment deadlines. Ofgem's original proposal to require suppliers to put in place credit protections remains the most effective way to protect consumers by minimising supplier exposure to the

[4] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/SoLR%20report%20FINAL_v2.pdf

risks of cost mutualisation. Therefore, whilst we recognise that Ofgem is introducing this principle in response to supplier feedback, we continue to believe further action is needed promptly.

Finally, we note that the current licence drafting under Condition 4B.1 states that suppliers must responsibly manage costs that could be Mutualised and "take appropriate action to minimise such costs". This suggests that suppliers will be under a duty to actively reduce RO costs, which is not possible under the Renewables Obligation Order 2015. We acknowledge that Ofgem may be making reference to consumer credit balances in this condition but would recommend that this is made clearer (if this is Ofgem's intent). Alternatively, we would request that Ofgem amends the drafting to acknowledge that costs may not be in a supplier's direct control – for example "take appropriate action to minimise such costs, or, in the event that costs are not within the supplier's control, take action to minimise the risk of cost mutualisation"

Promoting better risk management

Operational Capability Principle

SSE Business Energy supports Ofgem's aim to take a risk-based approach to monitoring supplier performance under this licence condition. We do, however, believe this condition duplicates requirements included in other rules (for example, the Standards of Conduct). Notwithstanding this, we consider that Ofgem needs to introduce a clearer definition for point c) which denotes that licensees must ensure they have and maintain robust internal capability, systems and processes to enable them to "comply with relevant legislative and regulatory obligations". This is extremely broad in scope and appears to have the potential to 'catch-all' legislation (e.g. financial markets, health and safety, employment law, data protection etc) which will not only be difficult for Ofgem to monitor but would potentially provide Ofgem with regulatory powers over rules subject to the jurisdiction of other regulatory bodies.

Dynamic Assessments

SSE Business Energy supports Ofgem's proposals to gather further information from suppliers where indicators of poor financial health or customer service exist, but we wish to highlight that this approach would not be effective unless Ofgem enforced the use of this power in a timely and proportionate manner.

Whilst the latest Request for Information on Covid-19 goes some way to provide Ofgem with relevant information, we consider that there remains a need for periodic monitoring to continue beyond the Covid-19 RFI to ensure Ofgem can appropriately review supplier financial performance. This must extend beyond looking at the impacts of Covid-19 – ultimately, cost mutualisation (such as that brought about by the RO scheme), is not new – it has been a significant issue prior to the pandemic and will extend beyond it without appropriate intervention. We consider that ongoing monitoring will enhance Ofgem's ability to act promptly where early indicators of supplier failure are identified and limit any contagion risk.

More responsible governance and increased accountability

Principle to be open and cooperative with the regulator

SSE Business Energy always aims to work openly and cooperatively with Ofgem, and supports formalisation of this approach through addition of a principle.

Increased market oversight

Customer Supply Continuity Plans

We note that Ofgem intends to proceed with introducing the requirement for suppliers to maintain a Customer Supply Continuity Plan. In theory, we understand Ofgem's view that this document could enhance the Supplier of Last Resort (SoLR) process. In practice, however, it will simply add further bureaucracy and be of limited value in its current form. It is not clear how Ofgem will monitor compliance with this obligation on an ongoing basis – potentially only uncovering non-compliance in the event of a SoLR being triggered. At this point, it would be too late for Ofgem to pursue any enforcement action and will only have added extra burden to remaining suppliers, who have taken steps to comply, and thus not fulfilled its intended purpose. Should Ofgem wish to implement the requirement, we would request that the requirement to produce a Customer Supply Continuity Plan is aligned to the requirements to undertake Milestone Assessments, Dynamic Assessments and notify Trade Sale events. It is our view that this will be a more proportionate approach, ensuring that Ofgem reviews the plans at intervals where higher risk is presented.

Moreover, the licence drafting suggests that the information within the plan must be "accurate" and "kept up-to-date at all times". Given the extent to which a supplier's portfolio can change, this will require significant administrative attention and is unlikely to always give a real-time and reliable view. We would suggest that, if implemented, Ofgem considers requiring suppliers to take "all reasonable steps" to keep plans accurate and up-to-date.

Independent Audits

SSE Business Energy understands Ofgem's rationale for commissioning an independent audit where poor financial or customer service indicators exist. We note, however, that the current drafting requires a final report to be shared with Ofgem but does not set out any requirement for updates to be provided to Ofgem in the event that significant issues are found. Ofgem may therefore wish to consider whether its existing powers allow it to maintain visibility of, and act on, this information as required.

Furthermore, we consider that the current definition of an Independent Audit as currently noted in the draft licence conditions will not provide Ofgem with the necessary assurance it requires when exercising this power. Although the auditor should be suitably qualified/regulated by an appropriate professional body, the current drafting would not prevent a supplier from appointing an individual/firm known to them. We would

recommend that Ofgem amends this definition to ensure it can be confident that the audit will be truly independent.

Our primary concern remains that Ofgem must minimise the risk of unviable suppliers remaining in the market for any longer than necessary. We therefore consider that Independent Audits (and Dynamic Assessments) should be used in conjunction with Ofgem's other powers, such as provisional orders, to ensure swift resolution and progression of issues around supplier failure to mitigate the contagion risk on other suppliers. Additionally, we would request that Ofgem provides transparency around use of these new powers. We consider that by publishing the actions it is taking to protect the market from the significant costs associated with supplier failure, Ofgem will provide credible deterrence to other suppliers.

Monitoring and Reporting Requirements

SSE Business Energy supports provision of the specified information to Ofgem under the 'Additional reporting requirement' but considers that amendments may be required to the current drafting to allow Ofgem to ensure these are effective.

Generally, Ofgem has set out the expectation that suppliers will provide notification of any change "if" it occurs but has not noted the right to request further information. We consider Ofgem may wish to revise the drafting to allow it to request any reasonable further detail in relation to the notification.

Trade Sales/Purchases

SSE Business Energy recognise the aims Ofgem is seeking to achieve but remain concerned that the drafting might act to delay or disrupt transactions which might otherwise be to the benefit of consumers. We would welcome further consultation on these issues to ensure the proposed solution achieves the desired aims.

Firstly, we note that there is no formalised definition of a Trade Sale/Trade Purchase in the drafting and would request that this is clarified.

Secondly, Condition 19AA.2 requires notification to Ofgem "if the licensee has agreed to undertake a Trade Sale or Trade Purchase". This may suggest that Ofgem does not expect notification until there is a binding legal agreement in place between the parties involved, however could also be interpreted as internal approval of a transaction in principle. Each scenario would be subject to different considerations under the Market Abuse Regulations (MAR) with the latter likely to be considered Inside Information which would create additional complexity for listed companies. In this case, a duty of confidentiality existing from Ofgem to the supplier would be required in order for the supplier to make this disclosure under MAR. We consider that the licence drafting should therefore reflect this, making reference to the fact that the information disclosed is confidential and potentially market sensitive, and should link to section 105 of the Utilities Act

2000.[5] We would recommend that Ofgem should provide clarification as to when it would expect compliance with this obligation to be triggered, and that this should take account of obligations under the Market Abuse Regulations.

Finally, SSE Business Energy deems that the requirement to notify Ofgem of a Trade Sale or Trade Purchase is broad in nature and consider that it is not necessary that Ofgem is made aware of all transactions, but rather only those which relate to suppliers in financial difficulty or raise the risk of supplier failure and associated mutualisation. This will minimise the requirements and complexity around provision of Inside Information and will avoid the delay or disruption to transactions which are genuinely intended to promote market integrity and protection of consumers.

Exit Arrangements

Customer Book Sales

SSE Business Energy notes that Ofgem has proposed the prohibition of Trade Sales/Purchases that "subvert or distort" the Supplier of Last Resort (SoLR) process. We consider that any sale or purchase could fall into this category if it changes the type or volume of customers who would be subject to the SoLR process, and therefore there is a risk this could be interpreted as a blanket embargo on all sales or purchases which may have otherwise progressed to SoLR. We consider that this may have unintended consequences of preventing commercial transactions which could benefit the market, such as those intended to rescue suppliers in financial distress. To ensure consumers are protected and not adversely affected, we suggest revising the drafting to capture Trade Sales/Purchases which both subvert or distort the SoLR process and have an identifiable element of consumer detriment, which would better reflect Ofgem's intent.

We also suggest that more prescriptive drafting is required around Ofgem's assessment of whether costs at risk of being Mutualised are "more likely". The current drafting indicates that this will be a subjective view from Ofgem based on interaction with the supplier and will likely mean in practice that a supplier may feel it is necessary to seek prior approval before a Trade Sale or Purchase completes. This may prejudice or delay commercial transactions which again are intended to benefit consumers, having the opposite effect from that intended. Additionally, a Trade Sale or Purchase will not necessarily make it "more likely" that costs will be mututalised by comparison to a SoLR event.

As noted above, SSE Business Energy recognises the aims Ofgem is seeking to achieve but is concerned that the current drafting may delay or disrupt transactions which might otherwise be to the benefit of consumers. We would welcome further consultation on these issues to ensure the proposed solution achieves the desired aims. We consider it would be helpful for Ofgem to set out the issues it identified as

[5] https://www.legislation.gov.uk/ukpga/2000/27/section/105

a result of those SOLRs which occurred shortly after a commercial sale / purchase completed and how these proposals would have functioned had they been in place at the time.